

EXECUTIVE INSIGHTS

HOW CAN CONTRACTORS BEST ADAPT TO TODAY'S SURETY MARKET?

BY JASON HUNTSMAN

Terence Cavanaugh

COO

Chubb Surety

To succeed in today's market, contractors need to align themselves with the best possible advisors. Experienced construction-oriented CPAs, specialized surety bond producers and insurance brokers, and an expert legal team are all important external components for a successful contracting operation. A contractor should share financial and operational records with his or her surety on a regular, open basis. It is also key for the surety to develop an in-depth understanding of the contractor's management team and the company's overall approach to risk management.

Mike Peters

President

Safeco Surety

Contractors can adapt to today's surety market by making sure they have a solid relationship with their surety and are dealing with a professional surety agent. That way, when issues come up they can be discussed and hopefully resolved fairly quickly. This is also a good time to focus operations in areas where firms can consistently make money. Surety credit is valuable, so "spend it" wisely. Small and emerging contractors should stay focused on the core business or market they know well. Contractors should not get enamored with top-line growth unless they

have built their balance sheet to withstand a poor job. Also, they should invest in the proper controls to fully understand the status of projects at all times.

Craig E. Hansen

Senior Vice President

Holmes Murphy & Associates, Inc.

President

The National Association of Surety Bond Producers

In today's surety market, contractors are being asked to supply more detailed financial statements on a more regular basis. Personal indemnity is much more likely to be required, and continued pricing discipline will occur, especially at the upper-end of the market where capacity is the primary concern of the contractor. In some cases, creative approaches to bonding will be needed—especially on long-term or mega-projects. Contractors working with a professional surety bond producer have a close ally who is well-informed and prepared to help the business adapt to these current market features.

William E. Cheatham

President

Zurich North America Surety

Most surety companies say they have returned to a back-to-basics approach to underwriting, which may mean to some nothing more than requiring accurate and timely financial data. More important may

be emphasizing the need for a contractor to maintain a strong working capital and equity position. Lacking strong financial resources can leave a firm vulnerable. In today's market, contractors should focus on raising profit margins on projects—there is too much general acceptance of taking jobs at low profit margins. Also, contractors need to renew focus on accepting only reasonable contract terms and conditions. Accepting contracts that are onerous can lead contractors into peril. An important benefit of working with a surety company is the expertise that it can provide in a contract review—ensuring that a contractor's best interests are preserved.

Geoffrey Haver

Senior Vice President and Construction Practice Leader

*Riggs, Counselman, Michaels & Downes,
An Assurex Global Partner*

A contractor can do several things to better position the firm in today's surety market. A contractor should: partner with a construction-oriented CPA, surety company and producer; keep all parties informed with frequent communication (sureties do not like surprises); retain profit to strengthen the balance sheet; supply timely and well-prepared financials; stay within areas of expertise; be wary of jobs that sound too good to be true; and continually train and educate project managers and estimators.

John Stanchina

Vice President

*Rutherford Companies,
An Assurex Global Partner*

The key for a new and emerging contractor is to have a clear and concise business plan, construction-experienced CPA, professional surety agent and legal professionals. The other key is being reasonable with growth objectives on projects and programs in order to ensure systems and finances can support operations. The temptation among emerging contractors is to take every deal that comes down the pike—it is typically one of those projects that does not truly fit the firm’s abilities that potentially puts the contractor at risk.

James E. Lee

President

*Old Republic Surety Company
Chair of the Board of Directors
The Surety Association of America*

Contractors should prepare their businesses for even the worst of situations. By developing strategies to address dire situations, a business can potentially come through intact. The end of the calendar year is approaching and is an excellent time to prepare meaningful financial statements that make sense to the user. It is advisable for the contractor to sit down with the surety bond producer and CPA to develop strategies for adapting to change. If a bonding program is terminated due to the departure of a surety or for another reason, are current solid financial statements ready if the need calls for making a presentation to another company?

Contractors should retain risk capital in their businesses and pay bills on time. Prompt payment to laborers and material suppliers is imperative, regardless of whether the particular parties are covered by a payment bond. Contractors also should take advantage of discount opportunities to save on material costs through prompt payments. Having an established unsecured bank line of credit is important not only to be able to make such prompt payments, but is also extremely useful should a contractor encounter a cash drain while waiting for receivables.

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John Welch

President and CEO

CNA Surety

Underwriting in the surety industry remains disciplined. Surety companies are requiring retention of profits in order to grow net worth and working capital. Sureties also continue to improve their security positions, requiring personal indemnity where deemed appropriate. Contractors should find a professional bond agent and listen to his or her advice. There are fewer short cuts to getting bonding than there were in the 1990s. Solid work experience coupled with a reasonable level of risk capital will allow entry into the bonding market.

Phil Tobey

Vice President of Surety

The Dale Group

To best adapt to today’s market, contractors need to keep an open mind and be prepared to make changes. Contractors should align themselves with a professional surety bond producer who works with a variety of sureties that possess various appetites for risk. The professional agent should be a problem-solver and close advisor. Sound advice from a surety professional is essential.

Michael F. Greer

Vice President Surety and Fidelity

Penn National Insurance

A solid contractor will spend the money for a construction-specific accounting and

estimating system. Knowing job status from a profit standpoint is extremely important to the contractor and to the surety. Don’t grow beyond the company’s capability and don’t go get the big job and then have to hire someone new to manage it. Be willing to walk away from work that doesn’t fit and make sure to know where bids are going, whether to a general contractor or a public owner. Don’t be the latest victim of the general contractor looking to pass off liability. Finally, read and fully understand all contracts before signing them.

Michael Cusack

Senior Vice President and Regional Surety Director

Aon Construction Services Group

Contractors should develop disciplined lines of communication with the bonding agent and surety underwriters; communicate effectively on a more regular basis with the surety provider; update the business plan throughout the year; avoid surprises by keeping underwriters updated on significant events; and make sure the underwriter understands the current strategy and agrees with the contractor’s intermediate and long-term vision for the enterprise.

Contractors should be disciplined in the use of surety credit. A prequalification process should be implemented to ensure that companies are deploying their bonding resources in areas that will generate the greatest return for their organizations.

Michael Murphy

Vice President

Bush, Cotton & Scott

Sureties are paying close attention to the degree to which a contractor relies on his or her bank of line of credit. If a firm constantly maximizes its line of credit, then warning flags may be raised. Sureties like to see liquidity to be assured that a contractor can absorb problems.

Sureties also pay attention to the geographic areas where contractors work and their areas of expertise. Basically, a contractor would do well to stick to what it knows best. Whether switching from bidding on

private jobs to public works, or moving into a new geographic area, changes of this nature raise sureties' concerns.

William A. Marino
Chairman and CEO

Allied North America

The expectations of sureties in today's marketplace are very easy to understand. They expect a quality financial presentation with sufficient levels of liquidity and loss-absorption power to meet the requirements of the current construction climate; a focused business plan with careful evaluation of any deviations and an eye toward risk management; and contracts entered with financially responsible parties with equitable contract terms and conditions.

Henry Nozko, Jr.
President

ACSTAR Surety

It is important that a contractor select a solid surety company and stick with it, treating it the same as a banking relationship. Shopping around and moving from surety to surety is not a good idea. A surety may feel more obligated to help a long-time client through a rough spot, whereas a contractor who bounces from surety to surety may be looked on less favorably. Maintaining the surety relationship is more important now than even a year ago. A contractor should carefully select a surety company and develop a sound relationship. This is vitally important, especially if all, or even a portion of a contractor's work, is in the public sector.

Mark Reagan
Chairman and CEO

Willis Construction Practice

Underwriting now focuses more on liquidity in a contractor's business and availability of capital at risk. For contractors, capital and earnings continue to drive the availability of surety capacity up or down accordingly.

While 10 years ago it was unusual for a sizeable account to have to post collateral, today it is not uncommon to ask for such and to have an inter-creditor lender involved. As sureties are taking on more risk, these steps ensure that they will have

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a place at the table should things go wrong on a project.

For contractors, there is more complexity and leverage against success than at any time in the past two decades. The good and great contractors will thrive, while the average and mediocre will find their survival threatened. As active players in the construction process, sureties see these risk drivers and continue to take a cautious view on all but the very strongest accounts.

Michael D. Williams
President

North American Construction Services, Inc.

With the return to solid underwriting and the focus on working capital and net worth as well as the CPA reporting requirements, there are a number of capable entities facing challenges in receiving surety credit. One solution to the problem is funds control/escrow. This tool helps the contractor to meet the requirements of working capital and net worth by the surety requesting that a funds disbursement agreement be set up to monitor the project. Funds control alone is not the answer but flexibility of the tool is.

A surety can require working capital deposits into the escrow account that will assure the surety that funds are available to start and finish the project. An additional condition of injecting other funds into the escrow account that are held similarly to collateral tends to solve the net worth problem. The funds come from the personal liquidity or net worth that has been drawn out of the company and con-

verted to hard personal assets. More and more contractors are seeking this solution, and obligees are delighted to have a third party adding comfort to the disbursement of the contract proceeds.

Stephen Pate
Senior Vice President

HCC Surety Group

Small contractors would do well by developing a truly clear-cut, consistent and credible set of financial statements. These should be shared with the surety not just on an annual basis, but also periodically throughout the year. In today's market, if a presentation does not conform to a surety's particular standards it may not receive favorable attention. With the help of a construction-experienced CPA, small contractors can develop a footprint of consistent, analyzable financials from year to year, whether they conform to audit, review or compilation standards.

The small contractor should pay close attention not only to business payments, but personal credit management as well. Because sureties are more likely to scrutinize personal financials of smaller firms, it is important to maintain a sound personal credit history.

Dennis Perler
President

Liberty Mutual Surety

This is an exciting time for the surety industry. The nation's aging and expanding infrastructure needs will continue to keep good public works contractors in high demand. Moreover, as the economy continues to improve, there should be increased public funding to rebuild roads, schools and other public works. While emerging from three difficult underwriting years, the surety industry today is ready to serve the nation's contractors. Most sureties recognize that stable and responsible underwriting is critical to maintaining long-term capacity and customer confidence.

Huntsman is communications manager for the Surety Information Office (SIO). For more information, contact SIO by email at sio@sio.org, call (202) 686-7463 or visit www.sio.org.